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National Security and
International Affairs Division

B-279693

April 17, 1998

The Honorable Michael N. Castle
Chairman
Subcommittee on Domestic and
International Monetary Policy
Committee on Banking and Financial Services
House of Representatives

Subject: U.S. Export-Import Bank's Asian Financial Exposure

Dear Mr. Chairman:

This letter responds to your request for information regarding the U.S. Export-Import Bank's (Eximbank) financial exposure¹ in Asian nations that have experienced financial difficulties linked to the region's recent economic crisis. As agreed, we are providing information on (1) the extent of the Eximbank's financial exposure in Indonesia, South Korea, the Philippines, Thailand, and Malaysia and what the Eximbank is doing to manage this exposure; and (2) the status of the Eximbank's 1998 fiscal year subsidy budget in view of the Asian crisis. The information provided in this letter reflects the Eximbank's financial exposure in these five Asian nations as of early 1998.

RESULTS IN BRIEF

The Eximbank's financial exposure in Indonesia, the Philippines, South Korea, Thailand, and Malaysia totaled just over \$9 billion as of December 31, 1997—about 17 percent of its total exposure of \$52.2 billion.² The Eximbank also has

¹Financial exposure includes direct loans to foreign buyers, guarantees of commercial loans that cover both political and commercial risks of nonpayment, and export credit insurance to cover risks of a foreign buyer defaulting on payment.

²By way of comparison, these nations accounted for approximately 12 percent of the Eximbank's total financial exposure at the end of fiscal year 1994.

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\$7.6 billion in pending or potential additional exposure in these nations.³ Eximbank officials report that to manage the Eximbank's Asian exposure they are closely monitoring projects that are experiencing potential problems in several of these nations. Specific efforts include organizing visits to the region by senior Eximbank officials, preparing internal studies on banks in two nations, and applying revised risk ratings (used to estimate potential defaults) to its existing portfolio and new business done in the region.

The Eximbank currently projects that its 1998 fiscal year subsidy budget⁴ will be expended by late June or early July. Eximbank officials attribute this situation to a smaller appropriation in 1998 and deals carried over from the previous fiscal year rather than to increased costs associated with Asian transactions. The Eximbank's board considered, but declined to act on, several options for dealing with its budgetary shortfall earlier this year. The Eximbank's board is receiving monthly updates on the agency's budgetary status and will reconsider options to address any shortfall in July.

EXIMBANK MANAGEMENT OF ITS FINANCIAL EXPOSURE IN FIVE ASIAN NATIONS

The Eximbank's total financial exposure of just over \$9 billion in Indonesia, the Philippines, South Korea, Thailand, and Malaysia is about 17 percent of its global exposure of \$52.2 billion. In addition, there is \$7.6 billion in pending or potential exposure in these five Asian nations. According to Eximbank officials, about \$400 million, or 5 percent, of these pending or potential transactions might reach the Eximbank board approval stage and be approved. While the Eximbank has had short-term insurance available for South Korea and Thailand, the recent economic crisis in Asia led to a surge in demand for this type of coverage. Therefore, in January 1998, the Eximbank established a \$750 million ceiling on total exposure for short-term insurance for South Korea and in March created a \$1 billion ceiling for Thailand, which the Eximbank is anticipating will be backed by a sovereign (government) guarantee. Previously there had been little demand for short-term insurance to these nations, but the crisis has made banks reluctant to extend credit for transactions in Asia, thereby increasing the demand.

³Pending or potential exposure includes preliminary commitments and outstanding letters of interest. Letters of interest are issued to assist exporters in negotiations with a potential foreign buyer and indicate the Eximbank's willingness to consider financing if a sale is completed.

⁴The Eximbank's subsidy budget is used to cover the total estimated net cost of its direct loans, guarantees, and insurance (in present value terms). Administrative expenses are covered by a separate appropriation.

The Eximbank has managed its Asian exposure through a combination of activities. These activities include attending high-level meetings in the region by the Chairman and staff to discuss economic conditions, undertaking internal studies to identify risky banks in South Korea and Thailand, and providing the Board of Directors monthly updates on the agency's budgetary status. In addition, the Eximbank has applied revised Interagency Country Risk Assessment System (ICRAS) ratings to its existing portfolio and new business done in the region. Because the ICRAS rating of Indonesia and South Korea was downgraded, the Eximbank will be required to set aside larger amounts of its subsidy budget for exports it covers to these nations.⁵ The Eximbank also monitors and reports on problematic or potentially problematic loans or guarantees in its Asset Management report to the board. Its most recent report, dated January 31, 1998, covers the Eximbank's global exposure and focuses on claims received and paid during the last 12 months, recoveries, "weak" credits by sector, and transactions being monitored for possible defaults. A more detailed discussion of the Eximbank's financial exposure in the five nations and issues being tracked by the Eximbank follows.

Indonesia

The Eximbank's financial exposure in Indonesia, about \$3.75 billion, represents 7 percent of the Eximbank's total current exposure. Indonesia ranks fourth, behind Mexico, China, and Brazil, on the Eximbank's list of countries with the highest financial exposure. The Eximbank's current exposure in Indonesia includes \$1.28 billion in direct loans, just over \$750 million of which was made to the Indonesian government. Of the \$1.97 billion in guarantees, about one-third is backed by the Indonesian government. The Eximbank has also authorized \$463 million in final commitments that are not yet operative but are considered part of its current exposure, mostly for direct loans. In addition, the Eximbank's pending/potential exposure in Indonesia is \$4.26 billion, the highest of the five nations discussed in this letter. The Eximbank says it is closely monitoring construction-related projects in Indonesia that have been affected by reduced demand associated with the economic crisis.

Philippines

The Eximbank's financial exposure in the Philippines is about \$2.57 billion, which represents 5 percent of the Eximbank's total current financial exposure. Direct loans total \$359 million, all for nonsovereign power and telecommunications projects, while guarantees total \$1.65 billion, of which 89

⁵The ICRAS process was established in 1991 and is used by the executive branch to uniformly evaluate for the U.S. government the country risk contained in foreign loans and guarantees. The Office of Management and Budget chairs the ICRAS process, and the Eximbank serves as the Secretariat.

percent is for nonsovereign power, airlines, and telecommunications projects. An additional \$136 million in guarantees have been authorized but are not operative, while another \$404 million in loans and guarantee claims authorized between 1984 and 1991 have been rescheduled. The Eximbank's pending/potential exposure in the Philippines is \$1.1 billion. The Eximbank's Asset Management Division report indicates that several Philippine companies with which the Eximbank has exposure have experienced significant stock price declines. However, Eximbank officials believe that the Philippines' economic situation does not pose a risk for Eximbank-supported projects overall.

South Korea

The Eximbank's financial exposure in South Korea is \$1.57 billion, representing 3 percent of the Eximbank's total current exposure. This total is comprised of guarantees extended to cover purchases by two Korean airlines. According to Eximbank officials, airlines have been affected by decreased demand for air travel in the region, which has created financial difficulties for one of the airlines. Thus, the Eximbank has taken steps to safeguard its interests. Not included in these figures is an additional \$500 million in short-term insurance, part of the \$750 million ceiling for such transactions the Eximbank established in January 1998. The Eximbank also has pending/potential exposure in South Korea of \$720 million.

Thailand

The Eximbank's financial exposure in Thailand is \$854 million, which represents 2 percent of the Eximbank's total current exposure. This figure consists of \$641 million in loans, \$194 million in guarantees, and an additional \$9 million for an authorized but not operative final loan commitment. To manage its exposure, the Eximbank initiated in March a ceiling of \$1 billion on short-term insurance similar to that for South Korea. The Eximbank's pending/potential exposure in Thailand is \$877 million. Eximbank documents we reviewed indicated the Eximbank is actively working with several Thai borrowers who are experiencing financial difficulties with projects in the cement, telecommunications, and petrochemical industries.

Malaysia

The Eximbank's financial exposure in Malaysia is \$301 million, of which nearly all is for guarantees extended to airlines. The \$301 million represents less than 1 percent of the Eximbank's total current exposure. According to Eximbank officials, these guarantees are not experiencing difficulties. The Eximbank's pending/potential exposure in Malaysia is \$662 million.

STATUS OF THE EXIMBANK'S SUBSIDY BUDGET
IN VIEW OF THE ASIAN CRISIS

The Eximbank projects that its 1998 fiscal year subsidy budget will be spent by June or July of this year.⁶ Eximbank officials stated that because the agency began fiscal year 1998 with a subsidy appropriation of \$683 million (\$43 million less than its \$726 million fiscal year 1997 appropriation) and carried over potential deals from the previous fiscal year, the shortfall was anticipated. As discussed earlier, ICRAS ratings for South Korea and Indonesia were lowered to take into consideration increased risk in those markets. As a result, the amount of subsidy that will have to be set aside to cover these transactions will have to be increased. However, Eximbank officials stated that increased subsidy costs may be offset by decreased demand for export financing support in these markets.

To meet its projected budgetary shortfall, the Eximbank's Chairman recently testified before the House Appropriations Subcommittee on Foreign Operations that the Eximbank will need to use some tied aid⁷ funds for non-tied aid transactions in both fiscal years 1998 and 1999. The Eximbank's board considered, but declined to act on, several other options for dealing with its budgetary shortfall earlier this year, including raising medium- and long-term fees it charges exporters and discontinuing coverage for deals in higher-risk markets that have higher subsidy costs.⁸ Eximbank officials told us that its board is receiving monthly updates on the agency's budgetary status and will reconsider options to address any shortfall in July.

⁶This estimate is based on the subsidy cost of deals expected to be considered by the Eximbank's board for approval between March and July 1998.

⁷"Tied aid" refers to foreign assistance that is linked to the purchase of exports from the country extending the assistance. Tied aid can consist of (1) foreign aid grants alone, (2) grants mixed with commercial financing or official export credits ("mixed credits"), or (3) low-interest-rate loans. The Eximbank has a tied aid capital projects fund that it uses to counter other nations' tied aid practices.

⁸In a 1996 review of Eximbank activities, we identified potential options for achieving budgetary savings. These options involved raising fees or reducing program risks while still maintaining the Eximbank's competitive position relative to other export credit agencies. See Export-Import Bank: Options for Achieving Possible Budget Reductions (GAO/NSIAD-97-7, Dec. 20, 1996).

SCOPE AND METHODOLOGY

To determine the nature and extent of the Eximbank's current and potential/pending financial exposure in Indonesia, the Philippines, South Korea, Thailand, and Malaysia, we reviewed Eximbank country exposure program summaries for each nation along with its regional exposure report. To understand how the Eximbank is managing its financial exposure in these nations, we interviewed senior Eximbank managers and also reviewed internal reports prepared by its Asset Management and Insurance Divisions.

To understand the implications of the Asian crisis for the Eximbank's current fiscal year budget, we interviewed the Eximbank's Chief Financial Officer and other senior staff and reviewed internal Eximbank budget documents that track projected financial expenditures for this fiscal year.

We conducted our work between January and March 1998 in accordance with generally accepted government auditing standards.

AGENCY COMMENTS

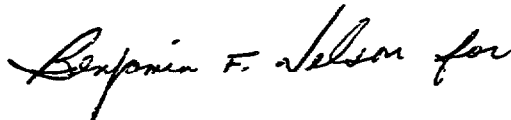
Eximbank officials who are familiar with the Eximbank's financial exposure and budget reviewed a draft of this letter and provided oral comments. These officials agreed with the information presented, and provided technical corrections which we incorporated where appropriate.

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We are providing copies of this letter to other interested congressional committees and the Chairman of the Eximbank. Copies will be provided to others upon request.

Please contact me at (202) 512-8984 if you or your staff have any questions regarding this letter. The major contributors to this letter were John Hutton and Phillip Herr.

Sincerely yours,



JayEtta Z. Hecker, Associate Director
International Relations and Trade Issues

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